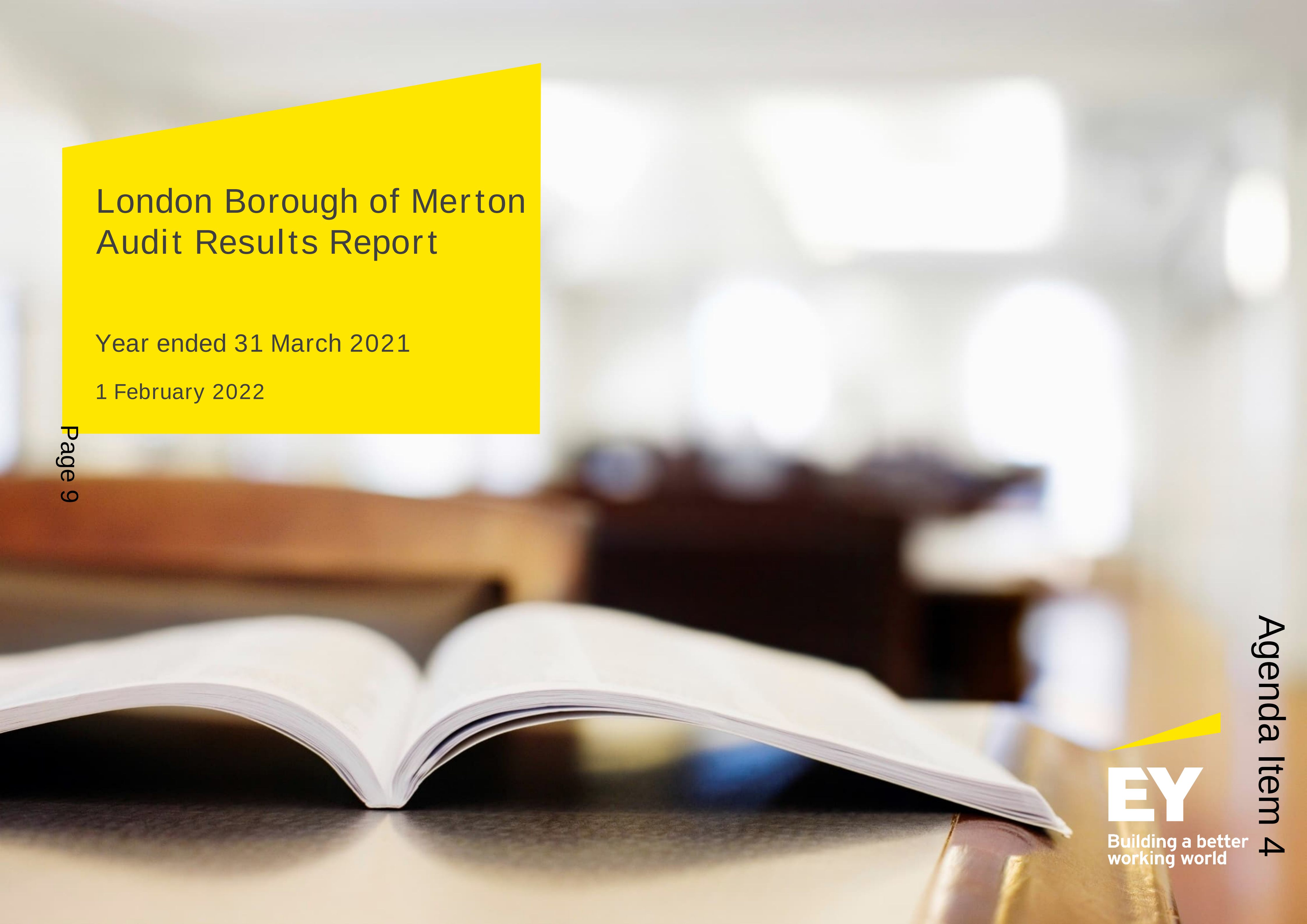

London Borough of Merton
Audit Results Report

Year ended 31 March 2021

1 February 2022

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Agenda Item 4

EY
Building a better working world

Private and Confidential

1 February 2022

London Borough of Merton
Standards and General Purposes Committee
Civic Centre
Morden
SM4 5DX

Dear Committee Members

2021 Updated Audit Results Report

We are pleased to attach our final audit results report, summarising the status of our audit of the London Borough of Merton (the Authority). We presented the report to the Standards and General Purposes Committee on 25 September and an update on the 4 November 2021.

The audit is designed to express an opinion on the 2021 financial statements and address current statutory and regulatory requirements. This report contains our findings related to the areas of audit emphasis, our views on the Authority's accounting policies and judgements and material internal control findings. Each year sees further enhancements to the level of audit challenge and the quality of evidence required to achieve the robust professional scepticism that society expects. We thank the management team for supporting this process. We have also included an update on our work on value for money arrangements.

This report is intended solely for the information and use of the Standards and General Purposes Committee, other members of the Authority and senior management. It is not intended to be and should not be used by anyone other than these specified parties.

We welcomed the opportunity to discuss the contents of this report with you at the Standards and General Purposes Committee meeting.

Further updates to this report subsequent to the meeting on 4 November have been highlighted in *red*.

Yours faithfully

E.Jackson.

Elizabeth Jackson, Associate Partner
For and on behalf of Ernst & Young LLP
Encl

Contents

Public Sector Audit Appointments Ltd (PSAA) issued the “Statement of responsibilities of auditors and audited bodies”. It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The “Terms of Appointment and further guidance (updated April 2018)” issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Standards and General Purposes Committee and management of the London Borough of Merton in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Standards and General Purposes Committee, and management of the London Borough of Merton those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Standards and General Purposes Committee and management of the London Borough of Merton for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Executive Summary

Executive Summary

Scope update

In our audit planning report presented to the Standards and General Purposes Committee meeting on 11 March 2021 , we provided you with an overview of our audit scope and approach for the audit of the financial statements. We carried out our audit in accordance with this plan, with the following updates:

Changes in materiality

We updated our planning materiality assessment using the draft financial statements and have also reconsidered our risk assessment

Materiality	Group (£m)		Authority (£m)	
	Outline Audit Plan	Final	Outline Audit Plan	Final
Planning Materiality	£9.8m	£10.0m	£9.6m	£9.9m
Performance Materiality	£7.3m	£7.5m	£7.2m	£7.4m
Audit Differences	£0.5m	£0.5m	£0.5m	£0.5m

Changes to audit risks and areas of focus

Description	Detail of changes to our scope
In our outline audit plan we identified the implementation of Adelente as a significant risk to our audit of the financial statements.	The Adelente system is a cash receipts only system which went live at the Authority on 29 March 2021. The total value of transactions in the financial year were below our performance materiality and we could agree the cash receipts recorded by the Authority back to third party bank confirmations and our review of bank reconciliations. Given the nature, timing and value of transactions processed through the system in 2020/21 we no longer consider the implementation of Adelente as a significant risk to our audit of the financial statements.
The Authority has a material Private Finance Initiative (PFI) arrangement in relation to schools. In our outline audit plan we highlighted the PFI as an area of higher inherent risk.	A detailed review of the PFI arrangements was undertaken by our internal expert in 2016-17 and followed-up in 2017-18, 2018-19 and 2019-20. Our review of the PFI model highlighted that there had been no changes to either the inputs or the model in 2020/21 and as such we reclassified this as a lower risk estimate. Our work on PFI confirmed that: • Outputs from the models were correctly reflected by the relevant accounting entries and disclosures in the financial statements. • PFI assets were correctly accounted for and disclosed.

Executive Summary

Scope update

Additional audit procedures as a result of Covid-19

Other changes in the entity and regulatory environment as a result of Covid-19 that have not resulted in an additional risk, but result in the following impacts on our audit strategy were as follows:

Information Produced by the Entity (IPE):

We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Fund's systems. We undertook the following to address this risk:

- Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and
- Agreed IPE to scanned documents or other system screenshots.

Changes to reporting timescales

As a result of Covid-19, new regulations, the Accounts and Audit (Amendment) Regulations 2021 No 263, have been published and came into force on 31 March 2021. This announced a change to publication date for final, approved financial statements from 31 July to 30 September 2021 for all relevant authorities.

Status of the audit

As at *1 February 2022* our audit work in respect of the Authority's opinion remains in progress. The following items relating to the completion of our audit procedures were outstanding at the date of this report:

- Final review of key working papers, including the Prior Year Adjustment consultation
- Update of our subsequent events procedures to the date of our opinion
- Final check of the updated financial statements and narrative report after completion of all outstanding procedures
- Receipt of a signed letter of management representation
- Whole of Government Accounts: We have yet to receive the NAO instructions on this for 2020/21.

Given that the audit process is still ongoing, we will continue to challenge the remaining evidence provided and the final disclosures in the Narrative Report and Accounts which could influence our final audit opinion, a current draft of which is included in Section 03.

Executive Summary

Auditor responsibilities under the new Code of Audit Practice 2020

Under the Code of Audit Practice 2020 we are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. The 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Authority a commentary against specified reporting criteria (see below) on the arrangements the Authority has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- Financial sustainability
  How the Authority plans and manages its resources to ensure it can continue to deliver its services;
- Governance
  How the Authority ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness:
  How the Authority uses information about its costs and performance to improve the way it manages and delivers its services.

Status of the audit – Value for Money

In the audit planning report presented to the Standards and General Purposes Committee in March 2021, we reported that we were yet to complete our value for money (VFM) risk assessment. We subsequently completed our planning risk assessment and did not identified any risk of significant weakness against the three reporting criteria we are required to consider under the NAO's 2020 Code.

We have revisited our assessment on completion of the audit of the financial statements and remain satisfied that we have not identified a risk of significant weakness. As a result, we have completed our planned VFM procedures. We plan to issue the VFM commentary as part of issuing the Auditor's Annual Report. There are no issues arising that impact on the auditor opinion report.

Executive Summary

Audit differences

Adjusted differences

Our audit of the Council's accounts has resulted in management making significant adjustments to the accounts.

Significant changes have been made to the carrying value of property, plant and equipment in the financial statements in the current and comparative years as a result of our work. These changes arise from judgemental differences between the Council's Valuer and EY Real Estate (EYRE) on land valued at Depreciated Replacement Cost (DRC). At the end of 2020/21, the total net book value of PPE increased by approximately £54.9 million as a result of the adjustments made.

The Authority has made all the above significant adjustments in the revised accounts. We include specific details in Section 2 in our response to areas of audit focus and Section 4 audit differences. A small number of other non material amendments were made to disclosures appearing in the financial statements as a result of our work.

Unadjusted differences

Our audit has identified *two unadjusted differences* which we are required to report.

Capital Grants (S106 grants)

We tested a sample of S106 agreements and with reference to Section 2.3 of the Code and determined which grants contained a condition and should be treated as a capital grant receipt in advance and those which contained restrictions and should be transferred to the capital grants unapplied reserve. Our testing highlighted a number of agreements that had been accounted for as a Capital grant receipts in advance where there were no conditions present and as such should be transferred to the capital grants unapplied reserve. The authority has made an adjustment of £1.8m as a result of the factual misstatement. Additionally there is an unadjusted extrapolated difference of £3.9m.

Property, plant & equipment (PPE)

Our testing of property plant and equipment identified a number of judgmental differences between the Council's valuer and EYRE, our internal specialist. When reviewing assets valued at DRC we noted that the Council applied a total useful life (TEL) of one hundred years when calculating obsolescence of the asset, whereas our internal specialist considered forty to sixty years to be more appropriate. When this was extrapolated across the relevant population this resulted in an immaterial £1.5m judgmental understatement of PPE.

Our testing also highlighted differences in the assumed rental income for a number of properties valued at existing use value. When the differences in rent were applied to the population this resulted in a judgmental understatement of the PPE balance of £1.7m.

The total £3.2m extrapolated understatement of PPE in relation to the two judgmental differences identified above is immaterial to the financial statements and therefore does not impact on the audit report.

Executive Summary

Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Authority. We have no matters to report as a result of this work.

We have not yet been able to perform the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission. This is because HM Treasury are continuing to review the online 2020/21 WGA Data Collection Tool (DCT) and update the guidance that is available for preparers. Therefore the 2020/21 WGA component data will not be available for auditors to review until after that. Group Audit Instructions and the timetable for 2020/21 will necessarily follow any changes HMT make to the DCT and process.

We have no other matters to report.

Areas of audit focus

In our audit planning report we identified a number of key areas of focus for our audit of the financial report of London Borough of Merton. This report sets out our observations and status in relation to these areas, including our views on areas which might be conservative and areas where there is potential risk and exposure. Our consideration of these matters and others identified during the period is summarised within the “Areas of Audit Focus" section of this report.

Fraud Risk	Findings & Conclusions
Misstatements due to fraud or error	Our planned work in this area is complete. We have not identified any material weaknesses in controls or evidence of material management override; instances of inappropriate judgements being applied; or any other transactions during our audit which appear unusual or outside the Authority‘s normal course of business.
Inappropriate capitalisation of revenue expenditure	Our sample testing of additions to Property Plant and Equipment and REFCUS: • Found costs had been correctly classified as capital and included at the correct value. • Did not identify any revenue items that were incorrectly classified as capital. Our review of judgements taken by management found them to be reasonable.
Significant Risk	**Findings & Conclusions**
Valuation of Land and Buildings	*A number of adjustments have been made to the financial statements as a result of our work in this area. Further details are set out in Section 02 of this report.*

Executive Summary

Areas of audit focus (continued)

Area of audit focus / Inherent risk	Findings & Conclusions
Going Concern	Management produced a going concern assessment. This was supported by cash flow forecasts through to March 2023. We reviewed the cashflow for reasonableness and the assumptions that underpinned them. We also reviewed and further challenged the going concern disclosure made by the Authority, checking for consistency with our knowledge of the Authority and the accounts. We are satisfied that it is an adequate reflection of management's assessment that it remains appropriate to prepare the financial statements on a going concern basis.
National Non-Domestic Rates (NNDR) Appeals Provision	Our work in this area is complete. The Authority has reviewed the figures provided by Analyse Local and made a local adjustment to reduce the value of the threats list by £5.8m, representing 50% of that suggested by Analyse Local. To evidence the reason for the reduction in provision the Authority has reviewed the top 25 properties by rateable value and identified that 50% of those threats would be unsuccessful. We have substantiated these explanations and as there is coverage across a number of property subclasses can take comfort that this is representative of the remaining population and conclude the local adjustment is reasonable.
Accounting for Covid-19 related government grants	Based on our work we are satisfied that the accounting treatment adopted for Covid-19 related government grants accorded with the Authority's assessment of whether it was acting as agent or principal, the underlying conditions of the grant and whether those conditions had been met. Our testing highlighted adjustments of £2.7m where the Authority had accounted for Covid-19 grants acting as agent but were in fact acting as principal.
Pension Liability and Asset Valuation	Our work in this area is complete. There were two low value adjustments to the valuation of fund liabilities on Merton Pension Fund due to a late adjustment to the valuation of level 3 investments. As these netted off no adjustment was required to the Authority's financial statements.

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Control observations

We have adopted a fully substantive approach, so have not tested the operation of controls.

We identified two control deficiencies *that we wish to draw to your attention in relation to the council tax and NNDR debtors reconciliation to the general ledger and the valuation of property, plant and equipment. More details can be found in section 7 of this report.*

Independence

Please refer to Section 08 for our update on Independence.

02 Areas of Audit Focus

Fraud risks

Misstatements due to fraud or error

What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We identify and respond to this fraud risk on every audit engagement.

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What did we do and what judgements did we focus on?

We:

- Inquired of management about risks of fraud and the controls put in place to address those risks.
- Gained an understanding of the oversight given by those charged with governance of management's processes over fraud.
- Considered the effectiveness of management's controls designed to address the risk of fraud.

We also performed mandatory procedures which we are required to undertake regardless of specifically identified fraud risks. We:

- Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
- Assessed accounting estimates for evidence of management bias, including estimates with a higher level of inherent risk relating to the revaluation of PPE, IP & surplus assets and pension liability and asset valuation.
- Evaluated the business rationale for significant unusual transactions.

We utilised our data analytics capabilities to assist with our work.

Having re-evaluated this risk we have considered whether we need to perform other audit procedures not referred to above. We continued to conclude that only those procedures included under 'Inappropriate capitalisation of revenue expenditure' were required.

What are our findings & conclusions?

Our testing in this area is complete.

Based on our work completed to date we have not identified any:

- material weaknesses in controls or evidence of material management override;
- instances of inappropriate judgements being applied; or
- any other transactions during our audit which appear unusual or outside the normal course of business.

Fraud risks (continued)

Inappropriate capitalisation of revenue expenditure

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What is the risk and potential impact on the financial statements?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We assessed that the risk of misreporting revenue outturn in the financial statements was most likely to be achieved through:

- Revenue expenditure being inappropriately recognised as capital expenditure at the point it is posted to the general ledger.
- Expenditure being classified as revenue expenditure financed as capital under statute (REFCUS) when it is inappropriate to do so.
- Expenditure being inappropriately transferred by journal from revenue to capital codes on the general ledger at the end of the year.

If this were to happen it would have the impact of understating revenue expenditure and overstating PPE additions and/or REFCUS in the financial statements.

What did we do and what judgements did we focus on?

We:

- Tested additions to ensure that the expenditure incurred and capitalised is clearly capital in nature.
- Considered the need to test REFCUS to ensure that it is appropriate for the revenue expenditure incurred to be financed from ring fenced capital resources. However, we note that expenditure capitalised as REFCUS was well below our performance materiality level so there was no requirement to undertake any detailed testing.
- Sought to identify and understand the basis for any significant journals transferring expenditure from revenue to capital codes on the general ledger at the end of the year.

In testing the capitalised expenditure we focused on the following judgements:

- We sought to gain assurance the capitalised spend clearly enhanced or extended the useful like of assets rather than simply repairing or maintaining the assets on which it was incurred.
- We sought to gain comfort that any development or other related costs that were capitalised were reasonable to capitalise i.e. the costs incurred were directly attributable to bringing the asset into operational use.

We sought to utilise our data analytics capabilities to assist with our work, including journal entry testing.

Fraud risks (continued)

What are our findings & conclusions?

Our sample testing of additions to PPE:

- Found costs had been correctly classified as capital and included at the correct value.
- Did not identify any revenue items that were incorrectly classified as capital.

Our review of judgements taken by management found that:

- Where relevant the capitalised spend clearly enhanced or extended the useful like of assets rather than simply repairing or maintaining the assets on which it was incurred.
- Other capitalised costs were directly attributable to bringing assets into operational use.

Our data analytical procedures did not identify any journal entries that incorrectly moved expenditure to capital codes.

Significant risk

Valuation of Land and Buildings

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What is the risk and potential impact on the financial statements?

The fair value of land and buildings represents a significant balance in the Authority's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. In the last two years the Authority has made improvements in its arrangements for supporting the production of materially accurate and complete valuations of its other land and buildings.

However, as one of the largest accounting estimates on the balance sheet and one dependent on a high degree of subjectivity we have continued to associate a significant risk to the valuation of land & buildings in the 2020/21 audit.

If land and buildings are incorrectly valued this could have the impact of understating or overstating the carrying value of assets and income and expenditure by a material amount.

What did we do and what judgements did we focus on?

We:

- Considered the work performed by the Authority's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.
- Sample tested key asset information used by the valuer in performing its valuation (e.g. floor plans to support valuations based on price per square metre) and challenged the key assumptions used by the valuer.
- Tested accounting entries have been correctly processed in the financial statements.
- Ensured that appropriate disclosure had been made in the accounts concerning the possibility of 'material uncertainty'.
- Commissioned EY Real Estates (EYRE), our internal specialists on asset valuations, to consider the valuation approach in more detail for a sample of assets. Sampling focussed on:
    - Assets more susceptible to the market volatility brought about by C-19. We consider this relates to assets carried at either fair value or EUV
    - Asset categories where errors were noted in the prior year.
    - Other significant classes of assets, for example schools, where we have no prior year knowledge of the approach of the new external valuer and there had been significant changes in the carrying value of assets from the prior year.
- Performed mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements

Significant risk

What are our findings & conclusions?

Significant changes have been made to the carrying value of property, plant and equipment in the financial statements in the current and comparative years as a result of our work. We commissioned EY Real Estates (EYRE), our internal specialists on asset valuations, to consider the valuation approach in more detail for a sample of assets. This work highlighted two significant issues with regards to the valuation of other land and buildings, specifically those valued at Depreciated Replacement Cost (DRC), which had a material impact on the carrying value disclosed within the financial statements:

- *The use of amenity land value for undeveloped land in non-school assets – The Authority applied a headline developed land valuation exclusively to the developed footprint on which the asset resides, it then applied a much lower amenity land value to the remainder of the site, including access and car parks. RICS guidance states that amenity land values should only be applied to playing fields in schools. Access, car parks and other associated land should be classified as developed land which attracts a higher value per acre. As amenity land has a much lower value than developed land value these non-school assets were largely undervalued; and*
- *The blanket use of discounted residential land rates to non residential assets valued at DRC - We also identified that the Authority applied a discounted residential rate ("school land predominantly in a residential area") value per acre to all non residential assets within the same geographical area within the borough. Under RICS guidance the Authority are required to consider each asset individually to determine the correct valuation basis, which could be a blended rate across locality types, to enable this the Authority should commission the District Valuer to also provide a town centre/commercial land value for each of the geographical areas within the borough.*

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In determining the adjustments required to the financial statements as a result of the identified errors we asked the Authority to consider the requirements of IAS 8 and the CIPFA Code of Practice on Local Authority Accounting (the Code) as to whether prior period adjustments were required to be made in respect of the error identified. The adjustments required are caused by errors in the valuation approach which have resulted in material errors in the carrying value of PPE and other associated entries in the financial statements and therefore meet the criteria for prior year adjustments set out in IAS 8 which is adopted by the Code. The errors in the Authority's valuation approach leading to the misstatements existed prior to the start of the comparative year disclosed in the accounts. The Authority has determined, and we agree, that it needs to restate and disclose corrected opening balances at the start of the comparative year i.e. prepare a 'third balance sheet' showing the restated financial position of the Authority as at 1/4/2018.

The correction of the two errors detailed above resulted in an increase to the carrying value of property, plant and equipment as follows:

- *At the end of 2018/19 the total net book value of PPE increased by approximately £47.5million;*
- *At the end of 2019/20 the total net book value of PPE increased by a further £2.2million; and*
- *At the end of 2020/21 the total net book value of PPE increased by a further £5.2million.*

The above adjustments impact the balance sheet valuation of land and buildings with the opposite entry being largely the revaluation reserve (part of unusable reserves).

Significant risk

What are our findings & conclusions?

Our testing also identified a number of judgmental differences between the Council's valuer and EY Real Estate (EYRE), our internal specialist, which have not be adjusted for in the financial statements.

When reviewing assets valued at Depreciated Replacement cost (DRC) we noted that the Council applied a total useful life (TEL) of one hundred years when calculating obsolescence of the asset, whereas our internal specialist considered forty to sixty years to be more appropriate. When this was extrapolated across the relevant population this resulted in an immaterial £1.5m judgmental understatement of PPE.

Our testing also highlighted differences in the assumed rental income for a number of properties valued at existing use value. When the differences in rent were applied to the population this resulted in a judgmental understatement of the PPE balance of £1.7m.

The total £3.2m extrapolated understatement of PPE in relation to the two judgmental differences identified above is immaterial to the financial statements and therefore do not impact on the audit report.

Considering our findings above we have made a control recommendation within section 7 of this report.

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Area of audit focus

Going Concern (Inherent Risk)

What is the risk?

There is a presumption that the Authority will continue as a going concern for the foreseeable future. However, the Authority is required to carry out a going concern assessment that is proportionate to the risks it faces. In light of the continued impact of Covid-19 there was a need for the Authority to ensure it's going concern assessment, including its cashflow forecast, is thorough and appropriately comprehensive.

The Authority was also required to ensure that its going concern disclosure within the statement of accounts adequately reflects its going concern assessment and in particular highlights any uncertainties it has identified.

In addition, the auditing standard in relation to going concern (ISA570) has been revised with effect for the 2020/21 accounts audit.

What did we do and what judgements did we focus on?

We:

- Challenged management's identification of events or conditions impacting going concern.
- Tested management's resulting assessment of going concern by evaluating supporting evidence (including consideration of the risk of management bias).
- Reviewed the Authority's cashflow forecast covering the foreseeable future to ensure that it has sufficient liquidity to continue to operate as a going concern, including an assessment of any underlying need to borrow.
- Undertook a 'stand back' review to consider all of the evidence obtained, whether corroborative or contradictory, in drawing our conclusions on going concern.
- Challenged the disclosure made in the accounts in respect of going concern and any material uncertainties.

What are our findings & conclusions?

Management produced a going concern assessment. This was supported by cash flow forecasts through to March 2023. We reviewed the cashflow for reasonableness and the assumptions that underpinned them.

We also reviewed and further challenged the going concern disclosure made by the Authority, checking for consistency with our knowledge of the Authority and the accounts.

We are satisfied that it is an adequate reflection of management's assessment that it remains appropriate to prepare the financial statements on a going concern basis.

Area of audit focus

National Non-Domestic Rates (NNDR) Appeals Provision

(Inherent risk)

What is the risk?

Statistics compiled by the Ministry for Housing, Communities and Local Government, reveal that authorities are forecasting net additions to appeal provisions totalling £927m this financial year, and £1.2bn next year.

The reason behind the forecast increase is that, due to the impact of Covid-19, businesses are likely to seek reductions based on a decrease in rental prices on which rateable values are based.

In light of this we consider there to be a higher inherent risk of misstatement of the Authority's NNDR appeals provision.

What did we do and what judgements did we focus on?

We considered the Authority's estimation of the NNDR appeals provision by

- Reviewing the assumptions made by the Authority's NNDR appeals provision specialist Analyse Local; and
- Assessed the reasonableness of any local adjustments made by the Authority on the NNDR appeals provision

What are our findings & conclusions?

Our planned work in this area is complete.

The collection fund contains a provision of £16.4m for the estimated cost of appeals against NNDR charges which may be settled in future years. The provision consists of £5.9m of threats, £6.6m of challenges from the 2017 appeals list and £3.9m from the 2010 appeals list, The Authority's share of this provision is £4.9m (30%).

We have assessed managements expert and reviewed the inputs they have used in formulating the provision and have no issues to report.

Further to this the Authority has reviewed the figures provided by Analyse Local and made a local adjustment to reduce the value of the threats list by £5.8m, representing 50% of that suggested by Analyse Local.

We challenged management as to the basis of this reduction and to evidence the reason for the reduction in provision the Authority has reviewed the top 25 properties by rateable value and identified that 50% of those threats would be unsuccessful. We have substantiated these explanations and as there is coverage across a number of property subclasses can take comfort that this is representative of the remaining population and therefore the reduction in provision is reasonable.

Area of audit focus

Accounting for Covid-19 related government grants (Inherent risk)

What is the risk?

The Authority has received a significant level of government funding in relation to Covid-19.

Whilst there is no change in the CIPFA Code or accounting standard (IFRS 15) in respect of accounting for grant funding, the emergency nature of some of the grants received and in some cases the lack of clarity on any associated restrictions and conditions, means that the Authority will need to apply a greater degree of assessment and judgement to determine the appropriate accounting treatment in the 2020/21 statements.

What did we do and what judgements did we focus on?

We considered the Authority's judgement on material grants received in relation to whether it is acting as:

- Agent, where it has determined that it is acting as an intermediary; or
- Principal, where the Authority has determined that it is acting on its own behalf.

We sought to determine whether conditions were attached to the grant funding received and whether those conditions were met or not.

Considering the outcome of the above we considered the appropriateness of the accounting treatment for the grants, in particular whether the grants were correctly classified, and whether associated disclosure were also accurate.

What are our findings & conclusions?

Based on our work we are satisfied that the accounting treatment adopted for Covid-19 related government grants accorded with the Authority's assessment of whether it was acting as agent or principal, the underlying conditions of the grant and whether those conditions had been met.

Our testing highlighted adjustments of £2.7m where the Authority had accounted for Covid-19 grants acting as agent but were in fact acting as principal. Following our identification of errors in the classification of the grants as agent/principal, the Authority undertook a detailed review of all Covid-19 grants to confirm whether the judgements made when preparing the accounts were accurate. We carried out additional testing of the Authority's work and this gave us the assurance that the total adjustment was reasonable.

Area of audit focus

Pension Liability and Asset Valuation (Inherent risk)

What is the risk?

The Local Authority Accounting Code of Practice and IAS19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by the Authority.

The Authority's pension liability is a material estimated balance and the Code requires that this liability be disclosed on the Authority's balance sheet. At 31 March 2021 this totalled £340m in the draft financial statements.

The information disclosed is based on the IAS 19 report issued to the Authority by its actuary.

Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

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What did we do and what judgements did we focus on?

We:

- Liaised with the auditors of Merton Pension Fund, to obtain assurances over the information supplied to the actuary in relation to London Borough of Merton.
- Assess the work of the pension fund actuary (Barnett Waddingham) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and
- Review and test the accounting entries and disclosures made within the Authority's financial statements in relation to IAS19.

We also considered outturn information available at the time we undertook our work after production of the Authority's draft financial statements, for example the year-end actual valuation of pension fund assets. We used this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments were required.

What are our findings & conclusions?

Our planned work in this area is now complete.

We previously reported that an issue had arisen across all local government audits that needed to be resolved prior to us being able to fully conclude our work. This was in relation to the impact of the revised auditing standard on accounting estimates. We planned to take an audit approach to this estimate based on procedures to evaluate management's process. The revised standard requires auditors to test the method of measurement of accounting estimates to determine whether the model is appropriately designed, consistently applied and mathematically accurate, and that the integrity of the assumptions and the data has been maintained in applying the model. Neither we, nor PWC as consulting actuaries commissioned by the NAO for all local government sector audits, were able to access the detailed models of the actuaries in order to evidence these requirements. We therefore modified our planned approach and undertook alternate procedures to create an auditor's estimate, to provide a different method of gaining assurance. The results of this exercise showed the actuarial estimate to be reasonable.

There were two low value adjustments to the valuation of fund liabilities on Merton Pension Fund due to a late adjustment to the valuation of level 3 investments. As these netted off no adjustment was required to the Authority's financial statements.

03 Audit Report

Draft audit report

DRAFT INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF MERTON

Our opinion on the financial statements

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Opinion

We have audited the financial statements of the London Borough of Merton for the year ended 31 March 2021 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- Authority and Group Movement in Reserves Statement,
- Authority and Group Comprehensive Income and Expenditure Statement,
- Authority and Group Balance Sheet,
- Authority and Group Cash Flow Statement and the related notes 1 to 43,
- Collection Fund and the related notes 1 to 6

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

In our opinion the financial statements:

- give a true and fair view of the financial position of the London Borough of Merton and Group as at 31 March 2021 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the authority and group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard and the Comptroller and Auditor General's (C&AG) AGN01, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Director of Corporate Services use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the authority's ability to continue as a going concern until March 2023.

Our responsibilities and the responsibilities of the Director of Corporate Services with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the authority's ability to continue as a going concern.

Draft audit report

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Other information

The other information comprises the information included in the Statement of Accounts 2020/21, other than the financial statements and our auditor's report thereon. The Director of Corporate Services is responsible for the other information contained within the Statement of Accounts 2020/21.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Authority;
- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014;
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014;
- we are not satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2021.

We have nothing to report in these respects

Draft audit report

DRAFT INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF MERTON

Our opinion on the financial statements

Responsibility of the Director of Corporate Services

As explained more fully in the Statement of the Director of Corporate Services' Responsibilities set out on page 188, the Director of Corporate Services is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21, and for being satisfied that they give a true and fair view and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the Director of Corporate Services is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority either intends to cease operations, or have no realistic alternative but to do so. The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the audit of the financial statements

objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below. However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

We obtained an understanding of the legal and regulatory frameworks that are applicable to the Authority and determined that the most significant are:

- Local Government Act 1972,
- Local Government Finance Act 1988 (as amended by the Local Government Finance Act 1992,
- Local Government Act 2003,
- The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 as amended in 2018 and 2020,
- The Local Government Finance Act 2012,
- The Local Audit and Accountability Act 2014, and
- The Accounts and Audit Regulations 2015.

Draft audit report

DRAFT INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF MERTON

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In addition, the Authority has to comply with laws and regulations in the areas of anti-bribery and corruption, data protection, employment Legislation, tax Legislation, general power of competence, procurement and health & safety.

We understood how the London Borough of Merton is complying with those frameworks by understanding the incentive, opportunities and motives for non-compliance, including inquiring of management, the head of internal audit and those charged with governance and obtaining and reading documentation relating to the procedures in place to identify, evaluate and comply with laws and regulations, and whether they are aware of instances of non-compliance. We corroborated this through our reading of the Authority’s committee minutes. Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations.

Our procedures had a focus on compliance with the accounting framework through obtaining sufficient audit evidence in line with the level of risk identified and with relevant legislation.

- We assessed the susceptibility of the Authority’s financial statements to material misstatement, including how fraud might occur by understanding the potential incentives and pressures for management to manipulate the financial statements, and performed procedures to understand the areas in which this would most likely arise. Based on our risk assessment procedures, we identified the inappropriate capitalisation of revenue expenditure and management override of controls to be our fraud risks.

- To address our fraud risk of inappropriate capitalisation of revenue expenditure we tested the Authority’s capitalised expenditure to ensure the capitalisation criteria were properly met and the expenditure was genuine.

- To address our fraud risk of management override of controls, we tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; assessed accounting estimates for evidence of management bias; and evaluated the business rationale for significant unusual transactions.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Authority’s website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor’s report.

Draft audit report

DRAFT INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF MERTON

Our opinion on the financial statements

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified reporting criteria issued by the Comptroller and Auditor General (C&AG) in April 2021, as to whether the London Borough of Merton had proper arrangements for financial sustainability, governance and improving economy, efficiency and effectiveness. The Comptroller and Auditor General determined these criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the London Borough of Merton put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2021.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the London Borough of Merton had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our work on value for money arrangements.

Use of our report

This report is made solely to the members of London Borough of Merton, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

04 Audit Differences

Audit Differences

In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as "known" or "judgemental". Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Summary of adjusted differences

Significant changes have been made to the carrying value of property, plant and equipment in the financial statements in the current and comparative years as a result of two issues identified as a result of our testing:

- *The use of amenity land value for undeveloped land in non-school asset – The Authority applied a headline developed land valuation exclusively to the developed footprint on which the asset resides, it then applied a much lower amenity land value to the remainder of the site, including access and car parks. RICS guidance states that amenity land values should only be applied to playing fields in schools. Access, car parks and other associated land should be classified as developed land which attracts a higher value per acre. As amenity land has a much lower value than developed land value these non-school assets were largely undervalued; and*
- *The blanket use of discounted residential land rates to non residential assets valued at DRC - We also identified that the Authority applied a discounted residential rate ("school land predominantly in a residential area") value per acre to all non residential assets within the same geographical area within the borough. Under RICS guidance the Authority are required to consider each asset individually to determine the correct valuation basis, which could be a blended rate across locality types, to enable this the Authority should commission the District Valuer to also provide a town centre/commercial land value for each of the geographical areas within the borough.*

In determining the adjustments required to the financial statements as a result of the identified errors we asked the Authority to consider the requirements of IAS 8 and the CIPFA Code of Practice on Local Authority Accounting (the Code) as to whether prior period adjustments were required to be made in respect of the error identified. The adjustments required are caused by errors in the valuation approach which have resulted in material errors in the carrying value of PPE and other associated entries in the financial statements and therefore meet the criteria for prior year adjustments set out in IAS 8 which is adopted by the Code. The errors in the Authority's valuation approach leading to the misstatements existed prior to the start of the comparative year disclosed in the accounts. The Authority has determined, and we agree, that it needs to restate and disclose corrected opening balances at the start of the comparative year i.e. prepare a 'third balance sheet' showing the restated financial position of the Authority as at 1/4/2018.

The following corrections have been made to the Authority's financial statements:

- *At the end of 2018/19 the total net book value of PPE increased by approximately £47.5million;*
- *At the end of 2019/20 the total net book value of PPE increased by a further £2.2million; and*
- *At the end of 2020/21 the total net book value of PPE increased by a further £5.2million.*

A small number of other non material amendments were made to disclosures appearing in the financial statements as a result of our work.

Audit Differences

Summary of unadjusted differences

Our audit testing identified two unadjusted differences which are explained below.

Capital Grants (S106 grants)

The CIPFA Code and accompanying guidance notes specify the treatment of Capital grants, specifically in relation to S106 contributions. Section 2.3 of the code on Government and Non-Government Grants and the associated guidance notes state that each agreement should be reviewed individually to determine the appropriate accounting treatment. The same section further states that the grant or contribution should be recognised immediately if there are no conditions outstanding and gives further guidance to describe the difference between a restriction and a condition.

We tested a sample of S106 agreements and with reference to the guidance detailed above determined which grants contained a condition and should be treated as a capital grant receipt in advance and those which contained restrictions and should be transferred to the capital grants unapplied reserve. Our testing highlighted a number of agreements that had been accounted for as a Capital grant receipts in advance where there were no conditions present and as such should be transferred to the capital grants unapplied reserve. The authority has made an adjustment of £1.8m as a result of the factual misstatement. We undertook additional sample testing to determine the maximum potential difference in the 2020/21 accounts. This testing determined that there is an unadjusted extrapolated difference of £3.9m.

Property, plant & equipment (PPE)

Our testing of property plant and equipment identified a number of judgmental differences between the Council's valuer and EY Real Estate (EYRE), our internal specialist. When reviewing assets valued at Depreciated Replacement cost (DRC) we noted that the Council applied an obsolescence factor of one hundred years, our internal specialist considered an obsolescence factor of forty to sixty years to be more appropriate. When this was extrapolated across the relevant population this resulted in an immaterial £1.5m judgmental understatement of PPE

Our testing also highlighted differences in the assumed rental yield for a number of properties valued at existing use value. When the differences in rent were applied to the population this resulted in a judgmental understatement of the PPE balance of £1.7m.

The total £3.2m extrapolated understatement of PPE in relation to the two judgmental differences identified above is immaterial to the financial statements.

We will seek management representation for these unadjusted differences. The unadjusted differences are immaterial and therefore do not impact on the audit report.

05 Value for Money

Value for money

The Authority's responsibilities for value for money (VFM)

The Authority is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

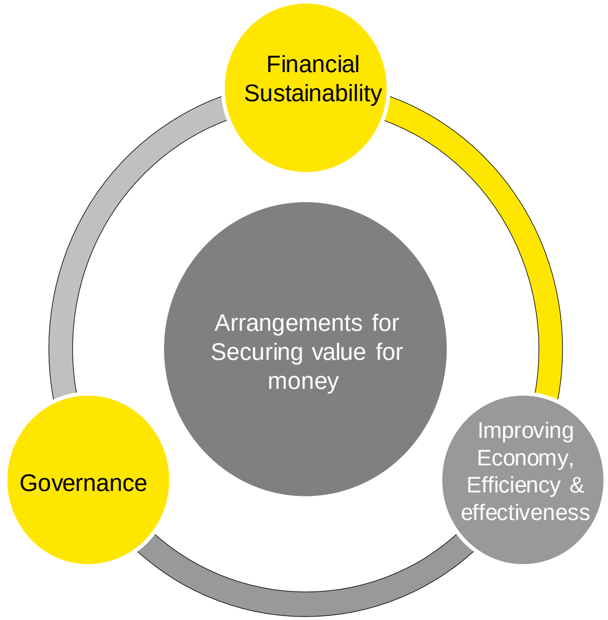
As part of the material published with its financial statements, the Authority is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the Authority tailors the content to reflect its own individual circumstances, consistent with the requirements set out in the Cipfa code of practice on local authority accounting. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

Risk assessment

In the outline Audit Planning Report presented to the Standards and General Purposes Committee in March 2021, we reported that we were yet to complete our value for money (VFM) risk assessment. We subsequently completed our planning risk assessment and did not identified any risk of significant weakness against the three reporting criteria we are required to consider under the NAO’s 2020 Code.

We have revisited our assessment on completion of the audit of the financial statements and remain satisfied that we have not identified a risk of significant weakness. As a result, we have completed our planned VFM procedures.

We plan to issue the VFM commentary as part of issuing the Auditor’s Annual Report. There are no issues arising that impact on our audit opinion.



06 Other reporting issues

Other reporting issues

Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Statement of Accounts 2020/21 with the audited financial statements We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance.

Financial information in the Statement of Accounts 2020/21 and published with the financial statements was consistent with the audited financial statements. We have reviewed the Annual Governance Statement and can confirm it is consistent with other information from our audit of the financial statements and we have no matters to report as a result of this work.

We have no other matters to report.

Whole of Government Accounts

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review, and the nature of our report, is specified by the NAO.

We have not yet been able to perform the procedures required by the NAO on the Whole of Government Accounts submission. This is because HM Treasury are continuing to review the online 2020/21 WGA Data Collection Tool (DCT) and update the guidance that is available for preparers. Based on the last available update the DCT and guidance is expected to be available in December 2021.

Therefore the 2020/21 WGA component data will not be available for auditors to review until after that. Group Audit Instructions and the timetable for 2020/21 will necessarily follow any changes HMT make to the DCT and process.

Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Authority to consider it or to bring it to the attention of the public (i.e. “a report in the public interest”).

We have no matters to report.

Other reporting issues

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must tell you significant findings from the audit and other matters if they are significant to your oversight of the Authority's financial reporting process. They include the following:

- Significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;
- Any significant difficulties encountered during the audit;
- Any significant matters arising from the audit that were discussed with management;
- Written representations we have requested;
- Expected modifications to the audit report;
- Any other matters significant to overseeing the financial reporting process;
- Findings and issues around the opening balance on initial audits (if applicable);
- Related parties;
- External confirmations;
- Going concern; and
- Consideration of laws and regulations.

We have nothing to report.

07 Assessment of Control Environment

Assessment of Control Environment

Assessment of Control Environment

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed and we considered whether circumstances arising from COVID-19 resulted in a change to the overall control environment of effectiveness of internal controls, for example due to significant staff absence or limitations as a result of working remotely.

As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control. We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware, but wish to draw the following issue to your attention.

Council Tax and NNDR Debtors

When undertaking the testing of council tax and NNDR Debtors we identified unreconciled differences between the Civica system and the general ledger. Whilst the balances were not material, council tax £0.9m and NNDR £1.4m, these differences have increased in 2020/21 and we would expect a full reconciliation to be undertaken routinely throughout the year.

Recommendation

The Authority should investigate the underlying reason and fully reconcile the debtor differences between Civica and the general ledger.

Property plant & equipment (PPE)

As reported in section 2 of this report our audit testing highlighted a number of issues with the valuation of property, plant and equipment included within the financial statements. Our work highlighted material differences in the valuation of developed land values and the incorrect application of amenity land values to property assets valued at depreciated replacement cost. This resulted in the Council having to restate prior year balances and increased the value of PPE at 31 March 2021 by £54.9m from that included within the draft financial statements. There were a number of other observations resulting in immaterial judgmental differences in relation to the calculated market rents for assets valued at depreciated replacement cost and using the incorrect obsolescence factor on assets valued at existing use value.

Recommendation

The Authority should review the findings from the current year audit and apply them to future years valuations. We would also encourage additional engagement with their specialists, the District Valuer, regarding the assumptions they have used when revaluing assets at depreciated replacement cost. This is in addition to the procedures they already engage with them on for assets valued at fair value and existing use value.

8 Independence

Relationships, services and related threats and safeguards

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and the Authority and its members and senior management and its affiliates, including all services provided by us and our network to the Authority, its members and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 April 2020 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Services provided by Ernst & Young

The table below sets out a summary of the fees that you have paid to us in the year ended 31 March 2021 in line with the disclosures set out in FRC Ethical Standard and in statute.

As at the date of this report, there are no future services which have been contracted and no written proposal to provide non-audit services has been submitted.

	Final proposed fee 2020/21	Planned fee 2020/21	Final Fee 2019/20
	£	£	£
Scale Fee – Code work	£110,493	£110,493	£110,493
Planned 2019/20 recurrent fee variation reflecting the underlying level of additional risk at the Authority yet to be agreed by the Authority or PSAA (See Note 1)	£102,541	£102,541	£102,541
Revised Proposed Scale Fee	£213,034	£213,034	£213,034
Risked based fee variations (see Note 2)	TBC	TBC	£36,300
Code of Audit Practice 2020 and updated auditing and accounting standards 2020/21 (see note 3)	£14,400	-	-
Total Fees	TBC	TBC	£249,334

Note 1 - In order to meet regulatory and compliance audit requirements not present in the market at the time of our most recent bid to PSAA, we undertook additional work at a fee of £102,541 to deliver the audit in 2019/20 which reoccurred in 2020/21 and we expect to reoccur in subsequent years. This additional fee has not been agreed with the Authority and is yet to be approved by PSAA.

Note 2 - The 2019/20 risk based fees have been agreed with the Director of Corporate Services but are yet to be fully approved by PSAA. We are yet to fully quantify 2020/21 risk based fee variations and agree them with the Authority. We will provide an update in due course. *This will include the extensive valuation work by EYRE and consultation for the prior period adjustment.*

Note 3 - The impact on audit fees of the new requirements in the Code of Audit Practice 2020 and new or updated auditing and accounting standards for 2020/21 audits as set out in the Additional information for 2020/21 audit fees issued by PSAA in August 2021. This paper sets out agreed fee ranges for the new requirements. For London Borough of Merton we determined this to be £10,000 for VFM and £4,400 in relation to the new estimates standard ISA540. This does not cover the additional work in relation to additional pensions assurance which was identified in September 2021.

Other communications

EY Transparency Report 2020

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2020:

EY UK Transparency Report 2020 | EY UK

9 Appendices

Audit approach update

We summarise below our approach to the audit of the balance sheet and any changes to this approach from the prior year audit.

Our audit procedures are designed to be responsive to our assessed risk of material misstatement at the relevant assertion level. Assertions relevant to the balance sheet include:

- Existence: An asset, liability and equity interest exists at a given date
- Rights and Obligations: An asset, liability and equity interest pertains to the entity at a given date
- Completeness: There are no unrecorded assets, liabilities, and equity interests, transactions or events, or undisclosed items
- Valuation: An asset, liability and equity interest is recorded at an appropriate amount and any resulting valuation or allocation adjustments are appropriately recorded
- Presentation and Disclosure: Assets, liabilities and equity interests are appropriately aggregated or disaggregated, and classified, described and disclosed in accordance with the applicable financial reporting framework. Disclosures are relevant and understandable in the context of the applicable financial reporting framework

There were no significant changes to our audit approach apart from the additional work we were required to undertake to address the requirements of the new auditing standard on accounting estimates. This primary impacted out audit procedures on:

- The revaluation of land and buildings classified as Property, Plant and Equipment (PPE), Investment Property (IP) and Surplus Assets.
- Pension liability and asset valuation.

Required communications with the Standards and General Purposes Committee

There are certain communications that we must provide to the those charged with governance of UK entities. We have detailed these here together with a reference of when and where they were covered:

		Our Reporting to you
Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Standards and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.	Outline Audit Plan, March 2021 meeting of the Standards and General Purposes Committee
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)

Appendix B

Required communications	What is reported?	Our Reporting to you: When and where
Fraud	• Enquiries of the audit committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • Unless all of those charged with governance are involved in managing the entity, any identified or suspected fraud involving: a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. • The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected • Any other matters related to fraud, relevant to Standards and General Purposes Committee responsibility.	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Related parties	Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence. Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Outline Audit Plan, March 2021 meeting of the Standards and General Purposes Committee Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)

Appendix B

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty related to going concern • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The appropriateness of related disclosures in the financial statements	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Material misstatements corrected by management	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Subsequent events	• Enquiry of the audit committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements.	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures.	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Consideration of laws and regulations	• Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur • Enquiry of the audit committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the audit committee may be aware of	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)

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Appendix B

		Our Reporting to you
Required communications	What is reported?	When and where
Significant deficiencies in internal controls identified during the audit	• Significant deficiencies in internal controls identified during the audit.	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Group Audits	• An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements.	Outline Audit Plan, March 2021 meeting of the Standards and General Purposes Committee Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Written representations we are requesting from management and/or those charged with governance	• Written representations we are requesting from management and/or those charged with governance	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)
Auditors report	• Key audit matters that we will include in our auditor's report • Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report, September 2021 meeting of the Standards and General Purposes Committee (updated November 2021)

Management representation letter

Management Rep Letter

Ernst & Young LLP
400 Capability Green
Luton
LU1 3LU
United Kingdom

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This letter of representations is provided in connection with your audit of the financial statements of the London Borough of Merton (“the Group and Authority) for the year ended 31 March 2021. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and Authority financial statements give a true and fair view of the Group and Authority financial position of London Borough of Merton as of 31 March 2021 and of its income and expenditure and its cash flows for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

We understand that the purpose of your audit of our financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing, which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

2. We acknowledge, as members of management of the Group and Authority, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows of the Group and Authority in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21, and are free of material misstatements, including omissions. We have approved the financial statements.

3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.

4. As members of management of the Group and Authority, we believe that the Group and Authority have a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 that are free from material misstatement, whether due to fraud or error. We have disclosed to you any significant changes in our processes, controls, policies and procedures that we have made to address the effects of the COVID-19 pandemic on our system of internal controls.

5. We believe that the effects of any unadjusted audit differences, summarised in the accompanying schedule, accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the consolidated and Authority financial statements taken as a whole. We have not corrected these differences identified and brought to our attention by the auditor because

Management representation letter

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a. We consider the extrapolated difference on the treatment of S106 grants to be immaterial to the reader of the financial statements as this represents a balance sheet classification difference only.

b. We consider the judgmental difference on the valuation of property, plant and equipment to be immaterial to the reader of the financial statements as this represents a balance sheet classification difference only.

6. We confirm the Group and Authority does not have securities (debt or equity) listed on a recognized exchange.

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B. Non-compliance with law and regulations, including fraud

1. We acknowledge that we are responsible for determining that the Group and Authority's activities are conducted in accordance with laws and regulations and that we are responsible for identifying and addressing any non-compliance with applicable laws and regulations, including fraud.

2. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

3. We have disclosed to you the results of our assessment of the risk that the consolidated and Authority financial statements may be materially misstated as a result of fraud.

4. We have no knowledge of any identified or suspected non-compliance with laws or regulations, including fraud that may have affected the Group or Authority (regardless of the source or form and including without limitation, any allegations by "whistleblowers"), including non-compliance matters:

- involving financial statements;
- related to laws and regulations that have a direct effect on the determination of material amounts and disclosures in the consolidated or Authority's financial statements;
- related to laws and regulations that have an indirect effect on amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operations of the Group or Authority's activities, its ability to continue to operate, or to avoid material penalties;
- involving management, or employees who have significant roles in internal controls, or others; or
- in relation to any allegations of fraud, suspected fraud or other non-compliance with laws and regulations communicated by employees, former employees, analysts, regulators or others.

C. Information Provided and Completeness of Information and Transactions

1. We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

2. All material transactions have been recorded in the accounting records and are reflected in the financial statements, including those related to the COVID-19 pandemic.

3. We have made available to you all minutes of the meetings of the Group, and Authority committees, including the Standards and general Purposes Committee held through the year to the most recent meeting on 21 September 2021.

Management representation letter

Management Rep Letter

4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Group and Authority's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the year ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.

5. We believe that the methods, significant assumptions and the data we used in making accounting estimates and related disclosures are appropriate and consistently applied to achieve recognition, measurement and disclosure that is in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

6. We have disclosed to you, and the Group and Authority has complied with, all aspects of contractual agreements that could have a material effect on the consolidated and Authority financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

7. From the date of our last management representation letter dated 5 November 2020 through the date of this letter we have disclosed to you any unauthorized access to our information technology systems that either occurred or to the best of our knowledge is reasonably likely to have occurred based on our investigation, including of reports submitted to us by third parties (including regulatory agencies, law enforcement agencies and security consultants) , to the extent that such unauthorized access to our information technology systems is reasonably likely to have a material impact to the financial statements, in each case or in the aggregate.

D. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the consolidated and Authority financial statements.

2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.

3. We have recorded and/or disclosed, as appropriate, all liabilities related to litigation and claims, both actual and contingent, and have disclosed all guarantees that we have given to third parties.

E. Going Concern

1. Note 42 to the financial statements discloses all the matters of which we are aware that are relevant to the Group and Authority's ability to continue as a going concern, including significant conditions and events, our plans for future action, and the feasibility of those plans.

F. Subsequent Events

1. Other than described in Note 42 to the financial statements, there have been no events, including events related to the COVID-19 pandemic, subsequent to year end which require adjustment of or disclosure in the financial statements or notes thereto.

G. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises the information included in the Statement of Accounts 2020/21, other than the financial statements and our auditor's report thereon.

2. We confirm that the content contained within the other information is consistent with the financial statements.

Management representation letter

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H. Estimates

a. Valuation of Property, Plant and Equipment

1. We agree with the findings of the specialists that we engaged to evaluate the valuation of assets and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the consolidated and Authority financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

2. We confirm that the significant judgments made in making the valuation of assets have taken into account all relevant information and the effects of the COVID-19 pandemic on asset valuations of which we are aware.

3. We believe that the selection or application of the methods, assumptions and data used by us have been consistently and appropriately applied or used in making the valuations.

4. We confirm that the disclosures made in the consolidated and Authority financial statements with respect to the accounting estimate(s), including those describing estimation uncertainty and the effects of the COVID-19 pandemic on the valuations, are complete and are reasonable in the context of the applicable financial reporting framework.

5. We confirm that appropriate specialized skills or expertise has been applied in making the valuations.

6. We confirm that no adjustments are required to the accounting estimates and disclosures in the consolidated and Authority financial statements.

b. Retirement benefits

1. On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

c. National non-domestic rates appeals provision

1. We believe that the measurement processes, including related assumptions and models, used to determine the accounting estimate have been consistently applied and are appropriate in the context of CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21

2. We confirm that the disclosures made in the consolidated and Authority financial statements with respect to the accounting estimate are complete, including the effects of the COVID-19 pandemic and made in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21.

3. We confirm that no adjustments are required to the accounting estimate and disclosures in the consolidated and Authority financial statements due to subsequent events, including due to the COVID-19 pandemic.

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